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Weekly Commentary, Selected Financial Data, and Business Indicators

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Bad News For The Economy

The pace of business slowed considerably in September and will probably continue to fade. The Government's index of leading economic indicators, which is designed to forecast economic activity two to three months ahead, collapsed by 2.7 per cent in September, month-over-month. This represents the largest monthly drop since April, 1980, when the economy was falling rapidly, leading to a 9.9 per cent annual rate drop in the "real" GNP for that year's second quarter. Similarly, the decline posted by the index of coincident indicators--which moves in tandem with economic activity—also demonstrates a weakening in business conditions. It has now declined for two months in a row and September's drop of 0.6 per cent is the largest since May, 1980.

Of the ten leading indicators available for September, eight declined. Importantly, the average workweek of production workers contributed the greatest decline and was responsible for more than one-third of the total slide. It contracted by 2.3 per cent in September, compared with the previous month, as many manufacturers cut production and reduced operating capacity in response to slowing final demand and swelling inventories. It does not augur well for the employment situation in the near future since more layoffs may be expected.

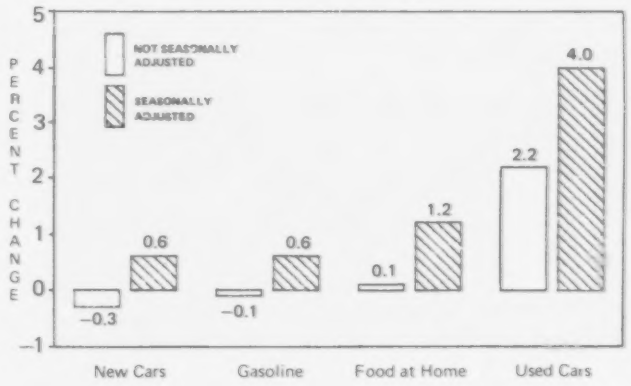
Purchasing managers of major corporations confirm a softening in the economy. A smaller number report slower deliveries from their suppliers than a month ago, which means that the economy is not as robust and industries are not as "busy" as they were earlier this year. This indicates that demand is waning and backlogs are diminishing. Building permits for new housing construction declined by 2.4 per cent in September, standing nearly 45 per cent below year-earlier levels. This portends further weakness for the construction sector and its related or "downstream" industries. Other indexes which contributed to the decline were: the layoff rate, new orders for durable goods in 1972 dollars, contracts and orders for plant and equipment in 1972 dollars, stock prices and the money supply. Only sensitive materials' prices registered an increase.

The CPI Is Not Perfect . . .

Depending on the method of measurement, the trend in the rate of inflation went in two opposite directions in September. When measured by the producer price index (PPI), inflation slowed to a miniscule 0.2 per cent, month-over-month, from 0.3 per cent in August. On the other hand, the consumer price index (CPI) jumped by 1.2 per cent during September, which translates into a 14.4 per cent seasonally adjusted annual rate before compounding. However, a trip to the supermarket, a new car showroom or a gasoline station is more likely to reveal a moderation in inflation, rather than a worsening—and for many items, even declines in prices.

It seems that the CPI exaggerated the rate of inflation because of statistical adjustments. The Bureau of Labor Statistics uses seasonal adjustment factors in an attempt to eliminate the effects of fluctuations which occur at the same time every year and are similar in magnitude. These include price movements resulting from such factors as changing

MONTH-OVER-MONTH PERCENT CHANGE IN SELECTED CPI INDEXES: SEASONALLY ADJUSTED VS. UNADJUSTED DATA (SEPTEMBER 1981)



climatic conditions, production cycles, model changeovers and holidays. The influence of these adjustments became particularly obvious in September on food, car and gasoline prices (see chart).

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. . . Overstating Several Components . . .

Food prices went up by a seasonally adjusted 1.2 per cent in September, from the previous month—the largest advance in almost a year. Without adjustment, they inched up only 0.1 per cent. It seems that in the case of agricultural products, it is almost impossible to adjust correctly for seasonality, since it is difficult to determine what the normal seasonal pattern is. Put simply, such unusual occurrences as drought, freezes, natural disasters, pestilence and long livestock cycles distort the outcome for a particular year which then improperly affects the following year's calculations. As a result, it is sometimes more useful to look at the numbers on an unadjusted basis. Actual results show that food price inflation moderated once again. The rise in food prices over the last two months has been 3.5 per cent, at an annual rate, while the adjusted index showed a jump of 12.3 per cent during this period.

Similarly, the actual price of new cars declined by 0.3 per cent in September, month-over-month, reflecting the extensive rebate programs offered by the major domestic manufacturers. However, the CPI, which factors out the "normal" seasonal price decline that occurs every year in early fall—because of clearance sales held by dealerships in order to make room for new models introduced in early October—shows an increase of 0.6 per cent.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/21/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	134.300	+ 2.316	+ 3.208
Loans to Depository Inst.	1.255	+ .145	+ .057
Float	3.649	+ .671	– 1.474
Total Reserve Bank Credit	148.742	+ 3.497	+ 5.509
Treasury Deposits with Federal Reserve Banks	3.743	+ .786	+ .542
Currency Outside Banks	124.807	+ 1.032	+ 4.810
Member Bank Reserves:			
Required	41.245	+ 1.503	– .875
Excess (Deficiency)	.275	– .010	+ .197
Total Reserves Held	41.520	+ 1.493	– .678
Net Borrowed Reserves	.825	+ .158	– .225
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	90.490	– .673	+ 4.891

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1-B	434.3	+ 2.9‡	+ 4.2‡
M2 (September '81)	1,786.6	+ 8.5	+ 8.6
M3 (September '81)	2,131.7	+ 10.1	+ 11.4
L (July '81)	2,523.8	+ 10.8	+ 11.5

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 10/30/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	12.75%	13.00%	12.80%
* Federal Agencies	13.95	14.40	15.40
* Project Notes—Taxfree (46% Taxable Equivalent)	14.72	15.56	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	14.85	14.90	15.63

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	14.25%	Nov.	14.40%
15- 29 days	14.38	Dec.	14.35
30- 59 days	14.50	Jan.	14.30
60- 89 days	14.50	Feb.	14.30
90-179 days	13.75	Mar.	14.30
180-239 days	13.75	Apr.	14.20
240-270 days	12.00		

‡Industrial Paper—Prime			
30- 89 days	14.38%	†Federal Funds Effective Rate	14.35%
90-120 days	14.38		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'81	$ 2,947	$ 2,886	$ 2,637
Gross National Product (1972 Dollars)*	3rd Q'81	$ 1,508	$ 1,510	$ 1,472
Percent Change, Annual Rate	3rd Q'81	– 0.6%	– 1.6%	2.4%
Change in Consumer Prices (all urban consumers)*	Sept '81	14.4%	9.6%	12.0%
Change in Producer Prices*	Sept '81	2.4%	3.6%	3.6%
Civilian Employment (Thousands of Persons)†	Sept '81	98,270	98,944	97,180
Unemployment as % of Civilian Labor Force†	Sept '81	7.5%	7.2%	7.4%
Personal Income*	Sept '81	$ 2,461	$ 2,441	$ 2,206
Leading Indicators Composite Index (1967=100)†	Sept '81n	130.1	133.7	134.4
Industrial Production Index (1967=100) †	Sept '81	152.1	153.3	144.4
Net Change in Consumer Installment Credit†	Aug '81	$ 2.86	$ 1.95	$ 0.49
U.S. Merchandise Trade Balance †	Sept '81n	–$ 1.57	–$ 4.48	–$ 1.11
Plant and Equipment Expenditures*	4th Q'81	$332.69(a)	$322.88(a)	$299.58
Private Housing Starts (Thousands of Units)*	Sept '81	918	934	1,482
New Construction Expenditures*	Aug '81	$ 231.0	$ 234.8	$ 217.9
Total Business Inventories†	Aug '81	$ 501.7	$ 498.1	$ 468.9
Total Business Sales†	Aug '81	$ 350.8	$ 354.5	$ 317.9

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

Importantly, gasoline prices demonstrated a similar divergence. While the price at the pump declined for the sixth month in a row, the adjusted index posted the first increase since March—a sizable 0.6 per cent. However, the seasonal factors which were applied to previous years may not apply today, since the usual demand pattern has changed dramatically over the past two years. For one thing, motorists have been driving less in general (Financial Digest—September 4, 1981) and taking fewer driving vacations. As a result, the difference between summer and winter consumption has narrowed. Instead of peaking during the three months ending in August, consumption has been declining, on balance, since June. Therefore, the traditional slump in driving—and motor gasoline prices—in September did not occur this year. However, the same seasonal factors have been used in the calculation which, in effect, resulted in a "phantom" price increase.

. . . But Is Getting Better

Finally, after many years of sharp criticism, the Bureau of Labor Statistics is attempting to reconstruct the CPI by changing the homeownership component which represents more than 25 per cent of the total index. The new experimental series translates the change in mortgage rates, home purchase prices, home repair and maintenance costs into a rent equivalent, whereas previously these were counted directly. Using the new measure, the rise in

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (10/14/81)	131,372	– 1,272	+35,376
New York City (10/14/81)	32,408	+ 2	+ 9,977
Commercial Paper (10/14/81)	162,704	– 492	+38,327

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/14/81)	188,364	+ 265	+22,045
New York City (10/14/81)	54,923	+ 51	+ 6,022

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/14/81)	459,358	– 1,288	+47,263
New York City (10/14/81)	110,617	+ 738	+15,306

Financial Markets

	Friday 10/30/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	13.25%	– .50	– .01
180-Day Bills†	13.85	– .92	+ .02
Longest Bills†	14.35	– .73	+ .69
Recent Issues:			
15 1/2s 10/31/83	14.30	– .96	
15 7/8s 9/30/85	14.65	– .67	
14 7/8s 8/15/91	14.50	– .86	
13 7/8s 5/15/11	14.47	– .29	
Municipals:			
Bond Buyer—20 Bond Index* (10/29/81)	12.99%	–0–	+ 3.54
Blue List Total ($ Million)	$ 821	+ $ 28	– $ 53
30-Day Visible Supply ($ Million)	$1,721	– $474	– $ 268
Total	$2,542	– $446	– $ 321
Corporates:			
Moody's Aa Composite (10/29/81)	15.95%	+ .11	+ 2.54
30-Day Visible Supply ($ Million)	$7,445	– $854	+ $3,822
Stocks:			
Dow-Jones Averages:			
Industrials	852.55	+ 14.56	– 71.94
Transportation	375.60	+ 8.44	+ 14.29
Utilities	106.85	+ 3.66	– 4.14
65 Stocks	340.63	+ 7.37	– 11.45
Standard and Poor's 500 Stocks	121.89	+ 3.29	– 5.58
N.Y.S.E. Composite Index	70.64	+ 1.81	– 2.89
N.Y.S.E. Avg. Daily Vol. for Week (000's)	47,846	+ 2,918	+ 9,596

* 46% Taxable equivalent 24.06%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/30/81	Week Ago
Overnight	14.25%	15.13%
1 month	15.06	15.63
3 month	15.75	16.31
6 month	16.06	16.56
1 year	16.13	16.50
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	15.75%	15.55%
Long Term (7 to 15 yrs.)	15.75	15.55

FOREIGN EXCHANGE SPOT RATES

New York Opening (10/30/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02657	37.64
Canada	.8306	1.2040
Denmark	.1383	7.2328
France	.1766	5.6625
Germany	.4433	2.2560
Italy	.0008333	1200.00
Japan	.004284	233.45
Mexico	.03915	25.54
Netherlands	.4023	2.4858
Switzerland	.5413	1.8475
U.K.	1.8453	.5419

the CPI would have been 0.8 per cent in September, compared with a 1.2 per cent month-over-month increase in the old index. What is more, since September, 1980, the CPI rose by 11.2 per cent, while the experimental one shows only a 9.2 per cent advance.

The old index overstated the monthly rate of inflation when mortgage interest rates were rising and understated it when rates were falling. In September, for example, home financing costs rose by 3.2 per cent, month-over-month, reflecting an increase of 2.5 per cent in mortgage interest rates and 0.7 per cent in house prices. The index incorrectly assumes that all homeowners have mortgages at prevailing rates, which change every month. Only those who have bought a new home in recent months—and their number has been dwindling—feel the pinch of rising home purchase prices and mortgage interest rates.

Despite the reconstruction of the CPI, the index does not incorporate the increasing number of creative mortgage financing schemes, which have, in effect, reduced home purchase prices and mortgage interest rates and have enabled purchasers to finance their new homes at below market interest rates. What is more, as was pointed out two years ago (Financial Digest—October 1, 1979), the index is not a cost of living measure, which seems to be a common misconception. Rather, every month it records the price changes of a fixed market basket of goods which is based on consumption patterns prevailing in 1972-73.

The CPI does not reflect consumption shifts, which are especially noticeable during periods of sharply rising prices when consumers switch to cheaper items. As a result, the impact of the more expensive item is greater than it should be, while the less expensive item is understated. The GNP deflator for personal consumption expenditures takes consumer preferences into consideration every quarter, when it is calculated. Therefore, it seems to be a better measure of the cost of living. H

monetary muscle

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When lack of money is fighting your clients' plans for expansion and profit, Manufacturers Hanover Commercial Corporation can match their tough financial needs.

MHCC is expert in non-notification techniques, which means our program does not disrupt your clients' credit and collection relationships.

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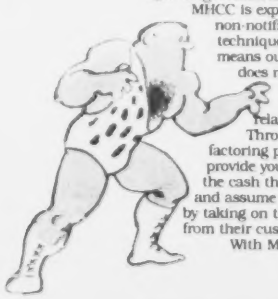

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